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INTERNATIONAL TRADE

Symposium on the Causes of the U.S. Trade Deficit



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The Honorable Robert Kasten
United States Senate

The Honorable William Frenzel
House of Representatives

As part of the response to your request that GAO study the causes of the increased U.S. trade deficit and ways that it could be reduced, we sponsored a symposium attended by leading international trade specialists on December 11, 1986. This is a summary of that symposium, published as a supplement to the GAO report The U.S. Trade Deficit: Causes and Policy Options for Solutions (GAO/NSIAD-87-135)

The summary was written by Professor Richard Cooper of Harvard University, who chaired the symposium. The agenda used by the participants is in the appendix

Copies of this summary are being sent to various congressional committees and other interested parties and will be made available to others upon request.

A handwritten signature in cursive script that reads "Allan I. Mendelowitz".

Allan I. Mendelowitz
Senior Associate Director

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Symposium on the Causes of the U.S. Trade Deficit—by Professor Richard Cooper, Harvard University

Symposium on the Causes of the U.S. Trade Deficit

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INTRODUCTION

This paper is a brief summary of a symposium held in Washington on December 11, 1986 on the causes of the U.S. trade deficit, the outlook for the deficit, and possible courses of action to deal with it. The participants in the panel were William Branson (Princeton University), Rimmer de Vries (Morgan Guaranty Bank), Jeffrey Frankel (University of California, Berkeley), Walter Joelson (General Electric), Robert Lawrence (Brookings Institution), Lee Morgan (Caterpillar Tractor and President's Export Council), and Marina Whitman (General Motors). The summary draws inspiration from the day-long discussion, but it is written solely on the responsibility of the author and the other participants in the panel cannot be held to it. What follows is organized successively around causes, outlook, and possible cures or solutions.

CAUSES OF THE DEFICIT

Facts and Concerns

The U.S. merchandise trade deficit (balance-of-payments basis) worsened from a deficit of \$25 billion in 1980 to a deficit of \$124 billion in 1985 and an estimated deficit of \$140 billion in 1986. During this period the current account position - merchandise plus services and investment income - deteriorated from a surplus of \$2 billion in 1980 (and \$6 billion in 1981) to a deficit of \$118 billion in 1985 and an estimated \$138 billion in 1986. Such a sharp deterioration in the U.S. trade accounts is a source of concern to many people because it seems to represent a drag on U.S. economic growth and a source of increased unemployment, as imports substitute for potential domestic sales. As the deficit grew, two additional concerns emerged: first, about the dependence on foreign capital inflows to finance the large current account deficit, and the possibility that foreign willingness to lend and invest in the United States might suddenly change, making the U.S. economy vulnerable to disruption from this source; and, second, about the accumulation of external debt which will result over a period of years in large American debt servicing requirements to foreigners.

Possible Explanations for the Deterioration

Many reasons have been advanced to explain this dramatic deterioration in the U.S. trade position. One puts heavy emphasis on foreign restrictions on imports of U.S. products and foreign incentives for foreign products which compete with U.S. goods in third country markets. A second focuses on the fact that during

much of the early 1980s the U.S. economy was growing more rapidly than many other countries, so U.S. demand for imports increased faster than foreign demand for U.S. exports. A third explanation, in part related to the second, focuses on the world debt crisis and the fact that U.S. exports are disproportionately concentrated on sales in Latin America, such that U.S. exports are depressed when Latin America is depressed, as it has been since 1982.

A fourth explanation, especially pertinent to the decline in U.S. agricultural exports, focuses on increases in world supply of agricultural products and, again, on the slow world economic growth which depressed commodity prices.

A fifth explanation focuses on the dramatic increase in the value of the dollar between 1980 and early 1985, relative to other leading currencies such as the Japanese yen and the German mark, with a consequential loss in price competitiveness of American products relative to products from those countries, both in the U.S. market and abroad.

A final explanation focuses on a loss of U.S. "competitiveness" apart from the factors mentioned above and in particular apart from appreciation of the dollar. This loss in underlying competitiveness in turn is attributed partly to the fact that U.S. productivity growth has been very slow, resulting in higher increases in unit labor costs than can be found in some (but not all) other industrial countries. It focuses in part on the rapid diffusion of new U.S. ideas abroad, such that the U.S. economy cannot enjoy the benefits for so long as it once did of producing and exporting new products in demand around the world, combined with the fact that innovation is taking place more rapidly abroad than it used to. The loss of competitiveness may also arise from lassitude by U.S. business management, an increasing preoccupation with short term financial results with correspondingly less emphasis on innovation and long term market development, the preoccupation with acquisitions and protection against being acquired, and an increasing dominance by lawyers and accountants as opposed to engineers and marketing specialists in the top management of U.S. corporations. Needless to say, a number of these explanations are highly debated and even contentious.

Judgments of the Panel

The panel registered the judgment that, while diverse explanations could plausibly be put forward, the deterioration in the U.S. trade balance over the early 1980s was overwhelmingly due to the rise of the value of the U.S. dollar. That of course did not occur in a vacuum. It was largely attributable to the monetary and fiscal policy mix in the United States and in other leading countries. In particular, the United States had a very expansionist fiscal policy from 1982 to 1985, leading to a large structural budget deficit, combined with a moderate to very tight monetary policy, whereas other leading countries such as Japan, Germany, Britain and (after 1983) France were all engaging in fiscal contraction. The net

effect of these policies was to stimulate economic activity and to raise interest rates in the United States (corrected for inflation) relative to those in other leading countries and thus to make the United States an exceptionally attractive place to invest. The inflow of foreign investment in turn pushed up the value of the dollar relative to other leading currencies, and that weakened the price competitiveness of American products.

An implication of this analysis is that a weaker dollar will help to improve the U.S. trade balance, as it did in the late 1970s. But the situation is not symmetrically reversible, partly because foreign firms have opened up new marketing channels in the United States which they will not lightly close down, and new American buying habits have been established which will not be readily reversed, and partly because the accumulation of current account deficits has increased the U.S. debt to foreigners, such that a legacy of debt servicing will remain even after a drop in the dollar to, say, the level in 1980. These developments in turn mean that U.S. trade performance in response to a weaker dollar will probably involve different goods, and therefore different regions of the country, from what prevailed in the early 1980s, with a corresponding requirement for long-term economic adjustment.

Some weight, five to twenty percent, was given by the panel to differential growth rates in explaining the deterioration of the U.S. trade balance. During the first half of the 1980s the U.S. economy grew more rapidly than many, particularly European, industrial countries, a reversal of the pattern that had taken place over the preceding three decades. This higher than usual U.S. growth rate meant that U.S. imports would grow more rapidly than U.S. exports to some of America's major markets. This point is reinforced by two factors. First, imports into the United States have historically risen somewhat more rapidly than U.S. gross national product, in contrast to the relationship in other major countries. Put another way, foreign growth rates would have to be somewhat higher than U.S. growth rates for U.S. imports and U.S. exports to grow together in a balanced way. Secondly, U.S. manufacturing exports are heavily concentrated in the area of investment goods, so it is not so much foreign growth as foreign investment which buoys up U.S. exports. Investment abroad has been exceptionally depressed during the last half decade, compared with previous periods, and that has taken its toll on American exports. It is worth noting that insofar as the U.S. trade deficit has emerged or enlarged because of more rapid U.S. economic growth, the concerns expressed about the dampening effect of higher U.S. imports on U.S. income and employment are somewhat misplaced. It is tautologically true that if imports had not grown and U.S. growth in demand had been the same, U.S. output and employment would have been somewhat higher. But insofar as U.S. imports have increased because of U.S. economic growth, it is not true that the U.S. economy has suffered because of imports. Rather, higher imports are the mechanism whereby U.S. growth is transmitted to America's trading partners.

The panel also gave consequential importance to the fact that Latin America has been economically depressed, and these countries play a disproportionate role as the destination for U.S. exports. Thus when Brazil and Mexico, two major markets, moved into economic decline as a result of their heavy external debt, U.S. exports suffered. As oil prices have fallen, spending by Organization of Petroleum Exporting Countries (OPEC) has also sharply diminished, in turn depressing U.S. exports (but also the exports of Europe and Japan).

There was some agreement that U.S. "competitiveness" had declined, although the importance of this variable is difficult to assess. The first point is that the term needs to be defined carefully, since it is a word that carries many different meanings. In particular, if we are to distinguish this from other factors it is necessary to correct the notion of "competitiveness" for changes in the exchange rate, for relative growth, and for the introduction or relaxation of trade restrictions. This leads to a focus on product quality, unit labor costs and unit capital costs in national currency, rates of innovation, new and aggressive market development abroad, and a host of other factors such as reliability in follow-on servicing. It is noteworthy that U.S. unit labor costs grew less rapidly than European unit labor costs measured in national currency during the early 1980s, but somewhat more rapidly than those in Japan. Much anecdotal evidence suggests a more rapid diffusion of new product ideas abroad than took place, say, ten or twenty years ago, such that U.S. firms enjoy the temporary monopoly of new product development less long than used to be the case, and this would represent some decline in U.S. competitiveness. So would more extensive new product innovation abroad, although the evidence on this development is not especially strong.

It is noteworthy that, according to the calculations of one panel member, the share of developing countries in U.S. imports of manufactured goods rose negligibly between 1981 and 1985, from 24.6 percent to 25.4 percent, suggesting that the widespread impression that U.S. production is being much more rapidly relocated to developing countries, and this is the source of U.S. import growth, does not carry much support. Manufactured imports from developed countries grew almost as rapidly. Moreover, while much is made in popular discussion of the large Japanese surplus with the United States, that surplus grew barely more between 1981 and 1985 than would have occurred if Japan merely got its 1981 share of the large U.S. deficit. A proportionate growth in Japan's trade with the United States would have resulted in a deterioration of \$28.6 billion, whereas the actual deterioration 1981-85 was \$29.9 billion. In other words, there does not seem to be much of a specifically Japanese factor in the worsening of the U.S. deficit either.

The panel agreed that trade restrictions against U.S. products played a negligible role in the emergence of the large U.S. trade deficit. If anything, trade restrictions today on American exports are lower than they were in 1980, and U.S. trade restrictions on

imports are greater than they were in 1980. So however frustrating the foreign trade restrictions may be, they cannot explain an enlargement of the deficit. It is more difficult to evaluate foreign incentives to exports. Agricultural policy of the European Community, and its emergence as the world's second largest exporter of agricultural products, are well known, but effective incentives for exports of manufactured goods are less clear. Examples can be found here and there, but they are not on a scale large enough to account for a major impact on the U.S. trade deficit. U.S. export controls play a considerable role in inhibiting U.S. exports, a point underlined recently by a panel of the National Academy of Sciences, which found that national security controls on U.S. exports probably resulted in a loss of \$9 billion in U.S. exports to non-communist countries. This effect arises from the effort of U.S. authorities to prevent U.S. militarily significant goods from reaching the Soviet bloc indirectly through third countries, and the installation of an apparatus that makes it difficult even for friendly nations to buy U.S. products. This system has been in place for many years, but it was markedly tightened in the early 1980s and thus may play some, albeit modest, role in enlargement of the U.S. trade deficit.

To sum up, one panel member allocated the causes of the deterioration of the U.S. trade balance for manufactured goods, which deterioration more than explains the total deterioration of the U.S. trade balance, 60 percent to the exchange rate, 20 percent to competitiveness, 15 percent to the debt crisis, and 5 percent to differential growth rates, while another panel member allocated 75 percent of the deterioration in the total trade balance to the exchange rate and macroeconomic policy, 20 percent to differential growth rates, and 15 percent to the debt crises. The sum adds to more than 100 percent because between 1980 and 1985 the United States garnered an improvement in its trade balance of over 25 percent as a result of a drop in the price of oil and in the quantity of oil imported.

OUTLOOK FOR THE TRADE BALANCE

Rimmer de Vries presented a projection of the U.S. trade balance and current account balance from 1986 through 1990, from which there was no major dissent (See Table 1). The main assumptions of the projection are that the United States would grow by 2.5 percent a year for the next five years, whereas the economic growth in the other industrialized countries would increase in 1987 to 2.8 percent and in the final three years of the decade to 3.1 percent a year. The U.S. dollar would decline marginally and then remain unchanged in nominal terms against the currencies of other industrialized countries, which implies a slight year to year appreciation in real terms. Interest rates are assumed to remain in the vicinity of 6 to 7 percent, with some year-to-year variation. Under these assumptions the merchandise trade deficit can be expected to improve by \$30 billion between 1986 and 1988 and then deteriorate further by \$40 billion by 1990. The improvement

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Table 1: Projection of U.S. current account deficit

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>
	-----billions of dollars-----					
U.S. current account with no further dollar depreciation	-\$118	-\$140	-\$133	-\$130	-\$147	-\$171
Trade deficit (cif)	-148	-165	-150	-135	-150	-176
Trade deficit (fob)	-124	-141	-124	-109	-123	-147
Invisibles excluding net interest	8	17	16	18	21	24
Net Interest	-2	-16	-25	-39	-45	-48
Net debt*	107	247	380	510	657	828
Interest rate (%)	7.7	6.5	6.6	7.6	6.8	5.8
Real growth (%)						
United States	2.7	2.5	2.5	2.5	2.5	2.5
Non-U.S. OECD		2.5	2.8	3.1	3.1	3.1
Effective dollar (1980-82=100)						
Narrow nominal	127	106	104	104	104	104
Narrow real	121	103	100	102	104	107
Memo:						
Current account with U.S. import income elasticity higher than foreign import income elasticity**			-138	-139	-162	-192

Source: Morgan Guaranty Trust Company

*Net debt is the net investment position of the United States with sign reversed. This concept assumes that the net equity position of the United States remains unchanged since the end of 1985 and that the counterpart of the current account deficit is a build up of interest paying U.S. liabilities abroad. The flow of income from the current net equity and direct investment position is included in service income.

**The model constrains both U.S. import and export income elasticities to a long-run value of 1.0. In this scenario, the long-run income elasticity is increased to 1.5 so if the United States and foreign economies grow at the same rate, U.S. imports increase more than U.S. exports.

in the current account position is more modest, only \$10 billion between 1986 and 1988.

It is noteworthy that the exchange rate assumptions of these projections leave the dollar somewhat stronger than it was in 1981 and about 10 percent stronger than it was in 1980. In other words, the sharp deterioration of the dollar in the latter half of 1985 and throughout 1986 only brought the dollar back to its 1981 level. The large depreciation merely offset the large appreciation that took place during 1981 through 1984. Given substantial lags in response to changes in the value of the dollar, trade figures in 1986 reflected exchange rates prevailing in 1984 and early 1985, and it will take several years for the depreciation of the dollar that occurred during 1986 to show up in the recorded trade figures, which reach their maximum effect during 1988.

A second noteworthy feature of the projections is that the continuing current account deficit implies that U.S. debt to foreigners rises from year to year through the remainder of the decade, and servicing requirements on that debt thus also continue to rise. On the assumptions given, U.S. servicing requirements of foreign debt will be \$23 billion larger in 1988 than they were in 1986, and by 1990 they will be \$32 billion larger than they were in 1986. So long as the deficit continues, increased debt servicing obligations contribute to future deficits.

A third noteworthy feature of the projections, underlying the trade figures, is that the United States can expect to have a rising bill for imported oil during this period, in sharp contrast to the falling bill between 1980 and 1985. Oil prices are expected to firm, and the quantity of oil imported is expected to rise, on both counts increasing U.S. payments for imports during the next five years.

It is of interest to know how sensitive these projections are to the various underlying assumptions, and in particular to foreign growth rates and to the value of the dollar. Alternative projections were presented, with growth in the rest of the Organization for Economic Cooperation and Development (OECD) countries assumed to be 1 percent higher during the period 1987 to 1990, that is, around 4 percent per annum. On de Vries' projections such a development would improve the U.S. current account balance by \$24 billion in 1990, which, while consequential, is a surprisingly small figure in view of the emphasis that U.S. authorities have been placing on faster growth in Europe and Japan. The view was expressed, however, that the impact on the U.S. current account of higher growth in Europe and Japan may be understated by this estimate, in part because U.S. exports are sensitive to the foreign rate of investment, and the rate of investment is likely to be much higher to sustain a growth rate of 4 percent in Europe and Japan. The projections fail to take that investment acceleration impact into account. Secondly, no allowance has been made for the impact of higher OECD growth on world primary product prices, hence on the earnings of developing

countries and the ability of those countries to import from the United States. But the quantitative impact of these two additional effects was not estimated.

An alternative projection was also made for a further 15 percent depreciation of the dollar during 1987 from rates prevailing in late 1986. This would take the real effective exchange rate roughly back to the level that prevailed in 1980, and would be consistent with exchange rates of 130 yen to the U.S. dollar, 1.6 marks per dollar, and 1.30 Canadian dollars per U.S. dollar (although other combinations of exchange rates could achieve the same overall result). Such a depreciation would improve the U.S. current account position by \$56 billion by 1990. These projections show that the two factors together would improve the U.S. current account balance by \$90 billion, bringing the deficit below \$100 billion but still leaving a substantial deficit.

CURES FOR THE DEFICIT

General Observations

It is important to understand the causes of the deficit clearly, to avoid fundamental misunderstandings about its nature and hence fanciful proposals for dealing with it. But it is also worth noting that identifying the causes of a phenomenon does not automatically lead to the solution, since causes may not be subject to policy manipulation and in any case other actions, unrelated to the underlying causes, may nonetheless help to rectify the situation.

In evaluating proposed cures, however, it is necessary to keep in mind the relationship between the current account deficit of any country to its total economy. From the national accounting identities, the total output of any economy (Y) must be disposed of through private consumption (C), domestic investment (I), government expenditure (G), or exports (X), after deducting the import content (M) of all of these magnitudes ($Y = C + I + G + X - M$). Similarly, total output gives rise to income which must either be consumed (C) or saved (S) or paid to the government in taxes (T), ($Y = C + T + S$). It follows from subtracting one of these accounting identities from the other that the current account deficit, $M - X$, must equal the difference between domestic investment, and private plus government savings, $I - S + (G - T)$. A reduction in the current account deficit therefore requires a reduction in the gap between domestic investment and private plus government savings, where the latter in turn is equal to the consolidated public sector surplus (Federal plus State and local). It is worth noting here that an investment boom, other things being equal, will worsen the current account deficit; similarly, a growing budget deficit, by increasing public dissaving, will also increase the current account deficit. A recession will lead to an improvement in the current account deficit if investment drops more rapidly than government tax revenues.

This relationship is an after the fact identity. It represents an important check on the consistency of any proposed policy, since in order to reduce the current account deficit the policy actions must also affect savings and investment in the required way. But this accounting identity says nothing about the dynamics of the impact of policy actions on the economy.

Increased Growth Abroad

The panel agreed that increased growth abroad would be desirable for its impact on the U.S. current account deficit, although there was some disagreement over just how important this effect would be quantitatively, and therefore on how much emphasis the Executive Branch should give to it. For example, the direct impact of a 2 percentage point increase in Germany's growth rate - a substantial increase - on the U.S. trade balance would be quite small. However, insofar as Germany operates as a constraint on growth elsewhere in Europe, a 2 percent increase in Germany's growth rate might lead to substantial increases elsewhere in Europe, increased rates of investment, and firming of world primary product prices and thus also enlarge the capacity of many developing countries to import.

Depreciate the Dollar

All panel members agreed that further depreciation of the dollar would eventually lead to an improvement in the U.S. trade balance, albeit with a lag that arises in part because of temporary reductions in margins by foreign suppliers in order to hold their U.S. market and in part to inevitable delays in shipments of new orders that follow the change in relative prices, both with respect to U.S. imports and especially with respect to U.S. exports. There was, however, some difference in judgment on how best to bring about a further decline in the dollar.

Some felt that the key to reducing the trade deficit was a sharp reduction in the U.S. budget deficit. Drawing on the National Accounts Identity noted above, a reduction in the budget deficit would increase national savings relative to investment and would result in an improvement in the current account balance. This result would be brought about by a reduction in long-term interest rates as the government experienced lower requirements for deficit financing, and that in turn would lead to a depreciation of the dollar, which would in turn lead eventually to an improvement in the trade balance. The relationship between the budget deficit, long-term interest rates, the exchange rate, and the trade balance is the key to the effect here, but because financial markets can work quickly, a firm and credible commitment to a reduction in the budget deficit might well lead to a reduction in interest rates and a depreciation of the dollar well before a substantial reduction in the observed budget deficit actually took place.

Others disputed the fact that a credible commitment to a reduced budget deficit, or even actual steps toward budget deficit

reduction, would lead to a depreciation of the dollar. On the contrary, they argued that a marked improvement in the U.S. fiscal situation, by strengthening general confidence in the U.S. ability to manage its economy, might well lead to a stronger dollar in the short run.

The dollar could also be depreciated through expansionary monetary policy undertaken by the United States alone. The U.S. administration during 1986 pressed on several occasions for a coordinated reduction in interest rates between the United States, Japan and Germany, with the objective of stimulating general economic activity without leading to a noticeable depreciation of the dollar, which among other things eventually will raise prices in the United States. This strategy concerns general macroeconomic policy for the industrialized nations. With a focus on the U.S. trade deficit, however, it is desirable to have some depreciation of the dollar, and that could be achieved by unilateral monetary expansion in the United States.

There was no discussion of the advisability of "talking the dollar down" through pronouncements by senior public officials. There is considerable disagreement among economists on the efficacy of such a strategy, with some in effect saying that such a policy can never affect the exchange rate in the absence of supportive moves on monetary, fiscal or other tangible policies. Others contend that under the right circumstances a policy of rhetoric can have a substantial market impact, insofar as it signals the views of senior officials, and hence possible future actions.

No one on the panel assumed that the United States would have to restore current account balance by the 1990s, but all agreed that it was highly desirable to reduce the deficit substantially, for the purposes of reducing the rapid buildup of external debt, avoiding the possibility of a financial crisis arising from foreign loss of confidence in the dollar, and avoiding protectionist action by the U.S. Congress. There was, moreover, general agreement that the dollar will have to depreciate further from its position in late 1986 in order to accomplish this result in view of the projections noted above. But there was disagreement on the desirable timing of such depreciation. Some argued for a further substantial depreciation of the dollar as soon as possible. Others worried that a further depreciation of the dollar following the sharp drop during 1986 would dislocate the economies of Europe and Japan, leading to a recession there and paradoxically worsening the U.S. trade deficit in the short run. The first group felt that this outcome was not inevitable, but that even if it did come to pass it may be necessary, however regrettable, in order to induce Germany and Japan to shift from an export-led economic policy to economic growth based on expansion of domestic demand - that is, to persuade these countries to adopt more expansionist monetary and fiscal policies.

At least one panelist felt that in the absence of action to bring about dollar depreciation, depreciation would occur automatically

as a result of the unwillingness of foreigners to lend to the United States on the scale necessary to finance continuing large current account deficits, resulting in at least a mini-crisis and leading simultaneously to a sharp rise in U.S. interest rates and a fall in the value of the dollar. Others felt that such a crisis in foreign confidence was certainly not inevitable, and perhaps not even likely.

Improved Competitiveness

All panel members agreed that while dollar depreciation would eventually reduce the trade deficit, the speed with which it took effect, and the extent of depreciation ultimately required, depends intimately on other aspects of export competitiveness - on product quality, on reliability of product and of follow-on servicing, on dollar cost and hence efficiency in production, on aggressiveness in export marketing, etc. Thus while macroeconomic developments determine the overall economic environment, sales success depends on individual firms and their management. Public policies supporting improved innovation, higher productivity, greater reliability, and enhanced marketing would thus reduce the depreciation ultimately required and would improve living standards of Americans. This line of thought leads to such broad issues of public policy as the quality of the educational system and the extent of encouragement to risk taking and investment. These important domains were noted but not discussed in detail by the panel. But it was agreed that there is a trade-off between price competitiveness as achieved by unit costs and the dollar exchange rate, on the one hand, and other dimensions of competitiveness such as quality, reliability, and marketing efforts abroad. Apart from the exchange rate, most of these matters are within the hands of individual firms, although some, such as official export credits, involve public policy.

The United States has a disposition to rely on private markets, but many buyers of investment and other goods today are foreign governments and their agencies, and these buyers have shown a tendency toward "interest rate illusion," whereby they attach more importance to the interest rate that they get on medium term credits for their purchases than they do on the price and quality of the products themselves, perhaps because interest rates are easily measurable and comparable among sellers. So long as other leading exporting nations rely heavily on official export credits, the United States should respond in kind to remain competitive in this dimension.

Alleviate the Debt Crisis

Investment remains heavily depressed in most developing countries. Growth can be assisted by alleviating the heavy burden of debt which many of these countries now have. While mechanisms were not discussed in detail, implied in this injunction is that the International Monetary Fund should lean more toward economic expansion in its programs for developing countries, on the

assumption that sufficient external financing can be found to support the more rapid growth, if necessary by allowing arrears by debtor nations to grow further. In other words, debt servicing of past loans should not get first claim on current export earnings of developing countries.

Alleviation of the debt burden can be helped if the International Development Association is replenished by the rich donor countries on schedule - a move that would affect mainly African and Asian countries - and if the World Bank were to get an increase in its capital so that it can increase further its program lending, especially to Latin America.

Avoid Trade Restrictions

All panelists agreed that it was undesirable to use import restrictions as a means of reducing the trade deficit, on several grounds. First, they would be emulated abroad, thereby impeding American export growth. Second, they almost always increase the costs, hence reduce the competitiveness, of other American products (for example, one panelist reported that his firm moved production of motors overseas because of the high cost of protected U.S. steel in the American market) and in this way U.S. exports are penalized. Third, import restrictions work to reduce the trade deficit only if they affect the savings-investment balance, as noted above, which is difficult for them to do and which therefore will lead to disappointing results. One panelist however favored an across-the-board import surcharge as a means of raising government revenues and reducing the budget deficit (and hence indirectly helping the trade balance) if no superior ways for raising revenue can be found. There was general agreement, however, that a tax on consumption of oil products would be a superior way to raise government revenue.

All panelists agreed that it would be desirable to reduce foreign barriers to U.S. exports, even though such restrictions have played little or no role in causing the deficit. The need for the United States to export is more manifest now than it was some years ago, and the occasion should be taken to open markets. Furthermore, such an approach represents a desirable and perhaps necessary aspect of political management of the large trade deficits. The governments of other industrialized countries generally still have strong "buy national" programs, despite the government procurement code of 1979, and they should be pressed harder to permit foreign competition in public procurement. Americans are not in a good position, however, to take a holier than thou stance on the question of import restrictions, or to assume that the U.S. deficit would not exist if foreign import restrictions had not been present. Such a stance would not be supportable by the evidence.

The United States creates its own serious impediments to U.S. exports, through a complex export licensing system for all medium to high technology products. This system is motivated by a desire to keep militarily significant technology from reaching the Soviet

Union and its close allies. But in the last several years the zeal displayed toward controlling indirect sales to the Soviet Union through Western countries or developing countries has led to a tightening of controls over U.S. exports to friendly nations as well, and this creates both a political irritation and, more importantly, an uncertainty about American firms as reliable suppliers, since buyers can never be sure, even if the license for the original product is approved, that they can count on spare parts and servicing at a later time. This perceived unreliability of the United States as a supplier, due to U.S. government intervention, has led some other countries to expand their own technological base through government support, and has led foreign firms to seek non-U.S. sources of supply if price and quality are reasonably competitive with American products. In short, it leads to bias around the world against buying from the United States. To reduce these costs to U.S. exports, the U.S. government should strive to make the export control system truly acceptable to other suppliers of high technology, mainly North Atlantic Treaty Organization (NATO) partners and Japan, and to effectively extend the control system around all these countries so that U.S. exports can move freely to Japan, western Europe, and other countries within the system.

At least one member strongly favored creation of a U.S.-Canadian free trade area as a mechanism for reducing the U.S. trade imbalance, but the issue was not discussed.

Issues for the GAO Symposium

What are the major causes of the U.S. trade deficit?

1. Academic discussions of the U.S. trade deficit tend to focus on the savings-investment imbalance. Discussions by businessmen of the trade deficit generally focus on issues such as foreign trade barriers, a loss of U.S. competitiveness, and unfair foreign trade practices. Which side is right? Or are they both right? How can the two arguments be reconciled? Is each side missing some aspect of the other's argument?

2. How would you define competitiveness and what would be the indicators that you would examine in analyzing its status in the United States?

3. What is the role of the U.S. budget deficit in determining the trade balance? Can the trade balance can be significantly reduced without reducing the budget deficit?

4. What is the effect of each of the following on the U.S. trade deficit? What percentage of the trade deficit does each of following account for.

- a. foreign non-tariff barriers
- b. differing growth rates in the U.S. and in foreign countries
- c. the high value of the dollar
- d. the debt problem in less developed countries
- e. loss of U.S. competitiveness

5. To what extent can the Federal Reserve Board affect the U.S. trade deficit through its monetary policy?

6. Do microeconomic factors such as foreign trade barriers and a decline in U.S. competitiveness have much effect on the trade deficit? If not, what effects do they have?

What will happen to the U.S. trade deficit in the next 3 years?

1. Has the dollar depreciated sufficiently to eliminate the current account deficit or must it depreciate even more?

2. How long can the United States continue to run \$100+ billion trade deficits? Is adequate U.S. economic growth possible with such large U.S. trade deficits?

3. Does it matter that the United States has become the largest debtor nation in the world? When will the United States have to repay this debt

or will it be able to increase it annually, much like the federal budget deficit?

4. What will happen when the United States has to repay its foreign debt? Will the U.S. standard-of-living fall?

What steps can the United States take to reduce the trade deficit? What are the costs of taking these steps?

1. What effect would the following actions have on the trade deficit:

- a. Coordinating intervention in exchange rate markets with other central banks
- b. Changing U.S. tax policy to increase investment opportunities
- c. Subsidizing U.S. exports
- d. Imposing an import surcharge
- e. Reducing U.S. budget deficit (Would it matter if done through increased taxes or reduced expenditures?)

2. To what extent do reductions in the U.S. trade deficit depend on the actions of other countries (e.g., foreign economic growth rates, foreign interest rates, LDC debt problems, foreign non-tariff barriers, etc.)

3. Should the U.S. attempt to persuade other countries to either increase their economic growth rates or increase the values of their currencies?

4. What other actions can Congress take to reduce the trade deficit?

5. Should the Fed attempt to lower interest rates in an attempt to lower the value of the dollar?

6. Has the United States lost competitiveness? If so, should any steps be taken to try to restore U.S. competitiveness to its previous level?

7. Have undue government regulations such as paperwork requirements and environmental regulations been major factors in the trade deficit? Should U.S. government regulations be reduced? Which ones?

8. What effect will the new tax laws have on the trade deficit? Will the elimination of the investment tax credit reduce investment and help erase the savings-investment imbalance?

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